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FISCAL IMPACT STATEMENT

LS 7434
BILL NUMBER: HB 1005

NOTE PREPARED: Jan 16, 2021
BILL AMENDED:

SUBJECT: School Choice Matters.

FIRST AUTHOR: Rep. Behning
FIRST SPONSOR:

BILL STATUS: As Introduced

FUNDS AFFECTED: **<u>X</u>** **GENERAL**
<u>X</u> **DEDICATED**
FEDERAL

IMPACT: State & Local

<u>Summary of Legislation:</u> This bill establishes the Indiana Education Savings Account Program (program). It provides that a parent of an eligible student or an emancipated eligible student may establish an account in the program, and defines an eligible student as:

(1) a student with a disability who requires special education;
(2) a student with a parent who:
(A) is on active duty service in the armed forces of the United States or national guard; or
(B) served in the armed forces of the United States or National Guard, received an honorable discharge, and has a service related disability; or
(3) a student placed in foster care or otherwise under care and supervision of the Department of Child Services.

The bill provides that an eligible student who has an account and attends a qualified school is eligible to receive an annual grant amount that may be used to pay for tuition at an accredited nonpublic school or education related expenses. It also provides that the treasurer of state shall administer the program.

The bill provides a deduction from Indiana adjusted gross income for a grant amount that is distributed to a taxpayer's Indiana education savings account and used for a qualified expense, to the extent the distribution is included in the taxpayer's federal adjusted gross income.

This bill changes the eligibility requirements to receive Choice scholarships. It makes changes to the amount of tuition an eligible choice scholarship student is entitled to receive to attend a Choice scholarship school. It also repeals provisions that provide eligibility to certain students if the student's household income increases.

The bill makes conforming amendments.

Effective Date: July 1, 2021.

Explanation of State Expenditures: *Summary-* The bill would increase state expenditures by over $108 M in FY 2022 and at least $94 M in FY 2023, assuming FY 2021 funding levels. The state expenditure increase would eventually decline to $75 M to $85 M annually after about five years. The largest sources of the expenditure increase are the bill's creation of the Indiana Education Savings Account Program, the expansion of the Choice Scholarship Program, and the cost of creating an online portal related to the Indiana Education Savings Account Program. Additionally, the bill requires the Treasurer of State to contract with:

1. One or more financial institutions to manage the accounts in the Indiana Education Savings Account Program; and
2. A public accounting firm to conduct an annual audit.

Both of those requirements would increase state expenditures. Finally, the Treasurer of State would experience a substantial workload increase that may require additional staff and resources. The Department of Education (DOE) and Department of State Revenue (DOR) would also experience workload increases, but could meet the bill's requirements with existing staff and resources.

Additional Information -

Indiana Education Savings Account Program: The bill establishes the Indiana Education Savings Account Program, which allows certain eligible students who are not on a Choice scholarship to receive a grant to attend an accredited private school and pay for other eligible education expenses. Under the bill, around 246,500 students would be eligible for the program, although only a portion of those students would participate in the program. The following table shows the estimated state expenditure increase for FY 2022, FY 2023, and over the long term, which is estimated to be five years.

Total State Expenditure Increase from the Indiana Education Savings Account Program		
FY 2022	FY 2023	Long Term
$64.9 M	$66.1 M	$68.2 M

The analysis assumes that the money deposited in the accounts of participating students is not reverted back to the State Tuition Reserve Account. However, many students would not utilize the full grant amount. The bill specifies that half of the grant amount can be carried over from one year to the next. If more than 50% of the grant amount for a student is not spent, that amount would revert to the state. Furthermore, if an account is terminated, the money in the account would also revert to the State Tuition Reserve Account. See the *Methodology* section for further information on the estimate.

Choice Scholarship Program Expansion: The bill expands the Choice Scholarship program by:

1. Increasing the income eligibility requirement for the Choice scholarship to 225% (in FY 2022) and 300% (in FY 2023 and all years thereafter) of the maximum amount to still receive free or reduced lunches (FRL).
2. Changing the Choice award structure so that students receive the lesser of 90% of the student's home school corporation's per student state tuition support, excluding the special education and CTE grants, or the cost of tuition and fees at the Choice school the student attends.

The following table shows the estimated state expenditure increase for FY 2022, FY 2023, and over the long term, which is estimated to be five years.

Total State Expenditure Increase from Choice Expansion		
FY 2022	FY 2023	Long Term
$32.2M - $33.8 M	$27.7 M -$31.4 M	$6.6 M -$15.5M

Online Portal: The bill provides that the Treasurer of State must provide entity and parent-friendly online services related to the Indiana Education Savings Account Program. Those services include:

1. The ability for parents to send, and participating entities to receive, payments from an eligible students' account.
2. A way for parents and entities to apply to the program.
3. The ability for parents to identify, select, and rate participating entities.
4. The ability for parents of eligible students to see the ratings of participating entities.

The cost of this project would depend on the specific business requirements the Treasurer of State would require. LSA's Office of Technology Services (OTS) estimates that the project would cost anywhere from $6.6 M to $11.2 M. Additionally, there would be ongoing costs related to site maintenance. However, the project would likely take 1 to 2 years to complete, and getting the project completed in 1 year would likely increase the costs substantially. The timeline provided by OTS indicates the online services may not be fully completed in time for the 2021-2022 school year. In order for a student to receive a grant in FY 2022, the bill requires the Indiana Education Savings Account for that student to be established by August 18, 2021.

Annual Audit: The bill requires the Treasurer of State to contract with an independent public accounting firm to conduct an annual audit of the Indiana Education Savings Account Program. While the cost of the contract(s) is unknown, the expenditure increase could be significant.

Contract with Financial Institutions: The bill requires the Treasurer of State to contract with one or more financial institutions to maintain and manage the accounts under the bill's Indiana Education Savings Account Program. While the cost of the contract(s) is unknown, the expenditure increase could be significant.

Treasurer of State: The bill's requirements represent an additional workload [and/or expenditure] on the Treasurer of State outside of its routine administrative functions, and existing staffing and resource levels, if currently being used to capacity, may be insufficient for full implementation. The administrative fees the bill allows the Treasurer of State to collect would help pay for some of the additional staffing and resource levels that would be required to implement the bill's provisions. Ultimately, the source of funds and resources required to satisfy the requirements of this bill will depend on legislative and administrative actions.

DOE: The bill's requirements are within the agency's routine administrative functions and should be able to be implemented with no additional appropriations, assuming near customary agency staffing and resource levels.

DOR: The DOR will incur additional expenses to revise forms, update instructions, and modify the existing tax processing system to implement this bill. The DOR's current level of funding and resources should be sufficient to administer this tax deduction.

Methodology - The impact the Choice expansion and the Indiana Education Savings Account Program have on state expenditures is dependent upon the type of schools students would have attended under current law. LSA used the following data sources to estimate the impact.

1. The population of students that would be eligible for the Indiana Education Savings Account Program.
2. The population of students that would be newly eligible for a Choice scholarship under the bill.
3. The percent of the students that would use their eligibility to switch from each school type to either the Indiana Education Savings Account Program or a Choice scholarship.
4. The fiscal impact of students leaving each school type to participate in the Indiana Education Savings Account Program or the Choice Scholarship Program.

The analysis that follows assumes FY 2021 funding levels. The estimates take into account that some students would be eligible for the Indiana Education Savings Account Program and would also be newly eligible for a Choice scholarship. Those students are assumed to participate in the Indiana Education Savings Account Program rather than the Choice Scholarship Program, as the benefit from the Indiana Education Savings Account Program would exceed that of the Choice scholarship.

Traditional School Corporations: The estimated number of students who would switch from a traditional school corporation to either the Indiana Education Savings Account Program or a Choice scholarship, and the associated expenditure decrease, are shown in the following table.

Count of Students Switching from Traditional School Corps under the Bill and Associated Expenditure Decrease			
	FY 2022	FY 2023	Long Term
Students	2,077 – 3,030	11,617 – 13,186	33,190 – 37,673
Expenditure Decrease	($1.9 M - $2.3 M)	($9.8 M - $12.2 M)	($27.9 M - $35.0 M)

While LSA estimates that between 33,190 and 37,673 students will eventually switch from a traditional school corporation to participate in the Indiana Education Savings Account Program or the Choice Scholarship Program, it is unlikely that all of the cost savings would occur in FY 2022. The shift will depend upon the timing of decisions to switch to the program. LSA estimates the full impact on traditional school corporations might take approximately five years, and 10% and 35% of the full impact will occur in FY 2022 and FY 2023, respectively.

Charter Schools: The estimated number of students who would switch from a charter school to either the Indiana Education Savings Account Program or a Choice scholarship, and the associated expenditure decrease, are shown in the following table. LSA estimates the full impact on charter schools might take approximately five years, and 10% and 35% of the full impact will occur in FY 2022 and FY 2023, respectively.

Count of Students Switching from Charter Schools under the Bill and Associated Expenditure Decrease			
	FY 2022	FY 2023	Long Term
Students	105 - 115	440 - 499	1,256 – 1,426
Expenditure Decrease	($0.08 M - $0.09 M)	($0.4 M - $0.5 M)	($1.1 M - $1.4 M)

Homeschool: The estimated number of students who would switch from homeschool to either the Indiana Education Savings Account Program or a Choice scholarship, and the associated expenditure increase, are shown in the following table.

Count of Students Switching from Homeschools under the Bill and Associated Expenditure Increase			
	FY 2022	FY 2023	Long Term
Students	193 - 198	407 - 424	815 – 848
Expenditure Increase	$1.2 M - $1.2 M	$2.5 M - $2.6 M	$5.0 M - $5.2 M

LSA estimates the full impact may take three to four years, and 25% and 50% of the full impact will occur in FY 2022 and FY 2023, respectively.

Non-Choice Private Schools: To estimate the number of non-Choice private school students who would become program participants under the bill, LSA used DOE data to discern how many students came from accredited schools (2,262) and how many came from non-accredited schools (19,172) last school year for a total of 21,434 students. LSA's estimate of the number of non-Choice private school students who would switch to either the Indiana Education Savings Account Program or a Choice scholarship under the bill, and the associated state expenditure increase, are shown in the following table.

Count of Students Switching from a Non-Choice Private School under the Bill and Associated Expenditure Increase			
	FY 2022	FY 2023	Long Term
Students	161 - 181	333 - 398	666 – 797
Expenditure Increase	$1.0 M - $1.1 M	$2.1 M - $2.4 M	$4.2 M - $4.8 M

While the full $4.2 M to $4.8 M expenditure increase is unlikely to occur in FY 2022, the increase is likely to come faster than the decrease in state expenditures from public school students. Students attending accredited schools would not need to switch schools in order to participate in the program as long as their school chose to be a participating entity. LSA estimates the full impact would take approximately three to four years, and 25% and 50% of the full impact will occur in FY 2022 and FY 2023, respectively.

Non-Choice Students Attending a Choice School: Using DOE data, LSA found that 37,895 students did not receive a Choice scholarship last year despite attending a school that participated in the Choice Scholarship Program. LSA estimates that between 11,884 and 12,087 of these students would be eligible for either a Choice scholarship or the Indiana Education Savings Account Program. LSA assumes:

1. All of these students would participate in one of the programs under the bill.
2. All Choice schools would also participate in the Indiana Education Savings Account Program.

Under these assumptions, state expenditures would increase by $71.1 M to $72.2 M in FY 2022 and $75.8 M to $76.5 M in FY 2023 and all years thereafter.

Choice Students Switching to the Program: Students currently on a Choice scholarship who would qualify for the Indiana Education Savings Account Program would likely switch to the program, assuming the Choice school has also signed up to participate in the program. The students would be able to continue to attend their Choice school, and the benefit from the program would exceed that of the Choice scholarship. LSA estimates that approximately 7,840 students would switch, increasing state expenditures by about $11.2 M. The vast majority of the expenditure increase would be expected to occur in FY 2022.

Change in Choice Award Structure: Removing the 50% and 70% awards would increase state expenditures by an estimated $15 M in FY 2022, assuming grant amounts remain the same compared to FY 2021. Under current law, LSA estimates there will be 10,898 students who will qualify for either the 50% or 70% Choice scholarship award in FY 2022. Some of these students will receive a lower scholarship amount equal to the tuition and fees charged to attend their school, but 6,212 students will receive the full 50% Choice Scholarship award, and 2,275 students will receive the full 70% award. This results in a total of 8,487 students (those receiving either the full 50% or 70% scholarship amount) who would be impacted in FY 2022. Of the impacted students, LSA estimates that approximately 2,882 would qualify for the tuition and fees award, and 5,605 students would qualify for the 90% award.

Additionally, some potential Choice scholarship recipients who were eligible for a 50% or 70% award, but ultimately did not participate in the program due to the out-of-pocket costs they would incur, might have their out-of-pocket costs reduced enough for them to now participate in the program. Since Choice scholarships decrease state expenditures relative to attending a public school, to the extent that students receive Choice scholarships instead of attending public schools, state expenditures will decrease. To the extent students who would have attended

1. Homeschool; or
2. A private school without a Choice scholarship

receive a Choice scholarship under the proposal, state expenditures would increase.

Explanation of State Revenues: *Administrative Fees:* The bill allows the Treasurer of State to charge an administrative fee of no more than 1% of the distributions made to the accounts in the Indiana Education Savings Account Program. The Treasurer of State is estimated to receive approximately $650,000 in FY 2022 and 960,000 in FY 2023.

Taxability of the Grant: The bill provides a tax deduction for the grants received and used towards qualified expenses. The tax deduction provided in the bill will result in a revenue loss only to the extent that any portion of grant would be included in the taxpayer's federal adjusted gross income. Any revenue loss will occur to the individual income tax deposited in the state General Fund.

Under current law, all or part of the amounts received as a scholarship, a fellowship grant, or other grants, can be deducted from federal, state and local taxes. It requires that the taxpayer be a candidate for a degree at an educational institution that maintains a regular faculty and curriculum and normally has a regularly enrolled body of students in attendance at the place where it carries on its educational activities. The exemption applies to the amounts received and used to pay for qualified expenses including tuition and fees required for enrollment or attendance at the educational institution, or for fees, books, supplies, and equipment required for courses at the educational institution. If and to the extent the grant or a portion of it does not meet the requirements, it is taxable and must be included in gross income. This bill provides the tax deduction to a broader range of expenses from the grant than allowed under current federal and state laws.

Explanation of Local Expenditures:

Explanation of Local Revenues: *Public School Revenue:* Public school revenue from state tuition support is driven largely by the average daily membership (ADM) which is a measure of the number of students enrolled and expected to attend a given school on a given date. To the extent that the bill encourages some students to attend a private school through the program rather than public school, public school revenue from state tuition support will decrease. The full impact of the bill could phase in over approximately five years. LSA's estimated ADM and revenue loss for traditional school corporations and charter schools are provided in the following tables.

Total Traditional School Corp ADM and Revenue Loss Compared to Current Law by Year			
	FY 2022	FY 2023	Long Term
ADM Decrease	2,077 – 3,030	11,617 – 13,186	33,190 – 37,673
Revenue Loss	($18.6 M - $20.3 M)	($77.8 M - $88.5 M)	($222.3 M - $252.7 M)

Total Charter School ADM and Revenue Loss Compared to Current Law by Year			
	FY 2022	FY 2023	Long Term
ADM Decrease	105 - 115	440 - 499	1,256 – 1,426
Revenue Loss	($0.7 M - $0.8 M)	($3.0 M - $3.4 M)	($8.5 M - $9.6 M)

Local Income Tax (LIT): Since the tax deduction could decrease the state adjusted gross income of certain recipients of the grant, it could decrease taxable income for LIT purposes. Counties imposing a LIT could potentially experience a decrease in revenue from this tax.

State Agencies Affected: Department of Education; Treasurer of State; Department of State Revenue.

Local Agencies Affected: Public schools, Counties.

Information Sources: Choice Scholarship Program Annual Report, Indiana Department of Education, June 2020, United States Census Bureau, National Center for Education Statistics, LSA education database, Indiana Department of Education, Department of Child Services, LSA's Office of Technology Services,
https://download.militaryonesource.mil/12038/MOS/Reports/2018-demographics-report.pdf

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